

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF GEORGIA
NEWNAN DIVISION

IN THE MATTER OF:

CASE NUMBERS

WILLIAM O'DELL McLAIN, JR.,

BANKRUPTCY CASE

Debtor.

NO. 01-12342-WHD

GARY W. BROWN, Trustee for the
Estate of William O. McLain, Jr.,

ADVERSARY PROCEEDING

NO. 02-1770

Counter-Claimant,

v.

JERILYN McLAIN,

Counter-Defendant

GARY W. BROWN, Trustee for the
Estate of William O. McLain, Jr.,

ADVERSARY PROCEEDING

NO. 03-1021

Plaintiff,

v.

WILLIAM O'DELL McLAIN, JR.,

Defendant

GARY W. BROWN, Trustee for the
Estate of William O. McLain, Jr.,

ADVERSARY PROCEEDING

NO. 04-1068

Plaintiff,

v.	:	
	:	
	:	
WILLIAM O'DELL McLAIN, JR.	:	IN PROCEEDINGS UNDER
	:	CHAPTER 7 OF THE
Defendant.	:	BANKRUPTCY CODE
	:	
	:	

ORDER

Before the Court are several pre-trial issues pending in three related adversary proceedings. All of these cases arise in connection with the bankruptcy proceeding of William McLain, Jr. (hereinafter the "Debtor"). Gary W. Brown (hereinafter the "Trustee") serves as the trustee of the Debtor's Chapter 7 bankruptcy estate and is the plaintiff in all three cases. The Debtor is a defendant in two of the adversary proceedings, while his wife, Jerilynn McLain (hereinafter "McLain"), is a defendant in one of the cases.

Adversary proceeding number 02-1770 is an action to set aside and recover for the benefit of the estate certain transfers of property the Trustee alleges were made from the Debtor to McLain. The Court previously granted in part and denied in part the Trustee's motion for summary judgment and the matter was deemed ready to proceed to trial. Adversary proceeding number 03-1021 is a complaint to revoke the Debtor's discharge, and adversary proceeding number 04-1068 is an action to revoke the Debtor's discharge. These matters were also deemed ready for trial. A pre-trial conference before the Court was scheduled for October 7, 2005. Counsel for the Debtor and McLain failed to appear for the

conference without excuse. The Court issued an order for counsel to appear and show cause why sanctions should not be imposed upon him for failure to attend the pre-trial conference. At that time, the Court ordered counsel to compensate the Trustee in the amount of \$300 for legal fees incurred through the Trustee's attorneys' attendance at the pre-trial conference.

A. Trustee's Motion for Entry of Order Resolving Pre-Trial Issues and Scheduling Matters for Trial and Debtor's Motion for Expedited Hearing for Determination of Pre-Trial Issues

The Trustee seeks a procedure that will bring the litigation before this Court to a close. The Debtor and McLain oppose such a procedure and request that the Court schedule a "proper" pre-trial conference and allow the parties to prepare a consolidated pre-trial order. From what the Court has seen in this case, the Debtor and McLain have been given every opportunity to cooperate in the preparation of a consolidated pre-trial order and to attend a "proper" pre-trial conference. Counsel for the Debtor and McLain has chosen not to avail himself of this opportunity and shall not be given leave to waste more of the Trustee's and the Court's time.

Having considered the Trustee's motion and the responses filed by the Debtor and McLain, the Court finds that:

1) The Debtor's Motion for Expedited Hearing for Determination of Pre-Trial Issues should be and hereby is **DENIED**.

2) The Debtor and McLain shall, **within 30 days of the date of the entry of this**

Order submit to the Trustee:

- a statement of all defenses they intend to assert in all three adversary proceedings;
- the names and addresses of all witnesses they intend to call at trial;
- the names of all persons whose testimony they will seek to admit at trial by way of deposition; and
- a list of all documentary evidence they intend to introduce at trial.

The failure to comply with the above requirement shall result in the striking of the answers filed by the Debtor and McLain in all three cases, at which point the Court will consider the merits of the Trustee's complaints and determine whether entry of default judgments in these cases is warranted, based solely on the Trustee's factual allegations;

3) The Debtor and McLain shall have **30 days** from the date of the entry of this Order to file with the Court any objections to the documents and witnesses that the Trustee intends to introduce and call, as provided in the Trustee's portion of the proposed pre-trial order (attached as Exhibit A to the Trustee's Motion for Entry of Pre-Trial Order and to Set Pre-Trial Procedures). If said objections are filed timely, the Court will set a hearing to consider the objections. If no objections are filed, any objection shall be deemed waived and said documentary evidence shall be admitted and said witnesses shall be allowed to testify. The Debtor and McLain shall continue to have the right to object to particular questions and

testimony asked of the witnesses during the course of the trial.

4) No further discovery shall be permitted without leave of the Court, with the exception of the Trustee's request to depose the Debtor's accountant in the event that the production of additional tax returns or transcripts warrant the taking of such deposition.

B. Trustee's Motion for Contempt and Motion to Compel Debtor to Execute Documents Necessary to Ascertain and Collect Property of the Estate

On October 18, 2005, this Court entered an order compelling the Debtor to fully respond to a subpoena for the production of certain tax returns. According to the Trustee's motion, the Debtor has yet to fully comply with the Court's October 18th Order. The tax information sought is relevant to the Trustee's efforts to determine whether the Debtor received any tax refunds that should have been turned over to the Trustee as property of the estate.

According to the Trustee's amended complaint, the Trustee has reason to believe that the Debtor filed tax returns for pre-petition tax years and requested refunds for taxes paid during those pre-petition years. If this is true, any refunds received are property of the Debtor's bankruptcy estate, as the Debtor had earned a right to the refunds prior to the petition date. *See* 11 U.S.C. § 541(a); *In re Doan*, 672 F.2d 831, 833 (11th Cir. 1982) (citing *Segal v. Rochelle*, 382 U.S. 375 (1966); *In re Barowsky*, 946 F.2d 1516, (10th Cir. 1991) (agreeing with the majority of courts that have held that "the portion of an income tax refund

that is based upon the pre-petition portion of a taxable year constitutes property of the bankruptcy estate”). The relevant tax years for this purpose appear to be 1999, 2000, and 2001.

The Trustee’s second allegation is that the Debtor used tax losses accrued during a pre-petition tax year against his post-petition income. The Court presumes that the Trustee’s argument is that these tax benefits were property of the estate and should not have been used by the Debtor to offset his post-petition income. The Trustee is correct that loss carryovers become property of the bankruptcy estate. *See In re Prudential Lines, Inc.*, 928 F.2d 565 (2d Cir. 1991). Pursuant to section 346(i)(1)(C), the bankruptcy estate succeeds to the tax attributes of individual debtors, including “any loss carryover.” 11 U.S.C. § 346(i)(1)(C). In order to ensure that individual debtors are provided with the fresh start provided by the discharge, if these losses are not used by the estate, they revert back to the debtor upon the closing of the case. *See id.* § 346(i)(2). Upon reversion, the debtor is permitted to use the losses. *See id.*

In this case, any tax losses incurred prior to the Debtor’s petition date became property of the estate and could be utilized by the estate. Assuming they exist, these losses have not reverted to the Debtor because the Debtor’s case has not yet been closed. Accordingly, the Debtor’s alleged use of pre-petition losses would have been an improper exercise of control over estate property.

The Court agrees with the Trustee’s position that the requested tax documents are

relevant and that complete and accurate records must be provided. If the Debtor cannot provide all of the documents required, the Court will order the Debtor to execute whatever forms are necessary for the Trustee to obtain access to that information. The Court suggests that, at least with regard to the federal returns, the best evidence of federal tax liabilities and refunds received would be the transcripts of the federal tax years at issue. The Court will allow the Debtor **45 days** from the date of the entry of this Order to obtain from the taxing authorities copies of complete federal and state tax returns, as filed and amended, and transcripts for all relevant federal tax years.

If the Debtor fails to comply timely with this request, the Trustee shall file an affidavit with the Court, at which time the Court will enter an order compelling the Debtor to execute the necessary forms to allow the Trustee access to the information and shall also sanction the Debtor by awarding the Trustee attorney's fees incurred in filing the instant motion, as well as the affidavit of non-compliance.

C. Debtor's Motion to Open Defaults

On July 13, 2005, the Trustee filed a motion to amend his complaints in adversary proceedings 03-1021 and 04-1068. The amended complaints were filed along with the motions. The Debtor did not object to the motions, and the Court entered orders permitting the amendments on July 28, 2005. The amended complaint in adversary proceeding 04-1068 alleges that the Debtor filed tax returns for pre-petition tax years and requested refunds for

those tax years and that the Debtor filed tax returns for post-petition tax years in which he used pre-petition tax losses to reduce his post-petition income. Although the Trustee does not know the amount of the pre-petition tax refunds or the exact nature of the pre-petition tax attributes used by the Debtor, the Trustee seeks turnover of any amounts received by the Debtor that are property of the estate. The amended complaint in adversary proceeding 03-1021 alleges that the Debtor's discharge should be revoked because the Debtor requested and received property of the estate and failed to disclose and turn over such property to the Trustee. The Debtor failed to file timely an answer to the amended complaints, and the Trustee moved for the entry of default, which was entered by the Clerk on October 6, 2005. On October 18, 2005 and December 22, 2005, the Debtor filed motions to open the defaults.

Having considered the Debtor's motion, the Trustee's response, and the applicable standard, the Court finds that the default should be opened. The Court would prefer to have the opportunity to determine whether the Debtor in fact received any tax refunds and whether and to what extent the refunds belong to the estate. As there are many matters pending in these proceedings that must be tried, the Court finds that permitting the Debtor an opportunity to defend against these claims, especially with regard to the revocation of his discharge, which is a serious matter, would not prejudice the Trustee. Accordingly, this matter shall be tried along with the remainder of the issues in these proceedings.

CONCLUSION

Having carefully considered all matters, and for the reasons stated above:

The Debtor's Motion for Expedited Hearing for the Determination of Pre-Trial Issues is **DENIED**.

The Trustee's Motion for Contempt and to Compel is **GRANTED** in part.

The Trustee's Motion for Entry of Pre-Trial Order is **GRANTED** in part.

The Debtor's Motion to Open Default is **GRANTED**.

The parties shall appear for trial on these matters on April 18, 2006 at 10:00a.m. in Second Floor Courtroom, 18 Greenville Street, Newnan, Georgia.

IT IS SO ORDERED.

At Newnan, Georgia, this 31 day of January, 2006.



W. HOMER DRAKE, JR.

UNITED STATES BANKRUPTCY JUDGE